APPLICATION OF

DALE SERVICE CORPORATION **CASE NO. PUE-2001-00200**

For an increase in rates

REPORT OF ALEXANDER F. SKIRPAN, JR., HEARING EXAMINER

December 11, 2002

Dale Service seeks to increase its rates to cover the costs of complying with new stricter regulations designed to protect the Chesapeake Bay. In order to comply with the new regulations, Dale Service has spent more than $32 million to construct a new sewage treatment plant and other facilities. Dale Service has entered into a Stipulation with the Staff, which, if adopted, produces a $73.75 quarterly residential rate and a $92.60 quarterly commercial rate.

HISTORY OF THE CASE

On April 6, 2001, Dale Service Corporation ("Dale Service" or "Company") filed an Application with the State Corporation Commission ("Commission") for a general increase in rates for services. In its Application, Dale Service proposed that rates and charges become effective September 1, 2001. The proposed rates and charges would produce $4,356,888 in additional annual operating revenues, or an increase of approximately 130% over current rates and charges. The Company maintained that the additional annual operating revenues are necessary to cover increased operating expenses, debt service, and other costs associated with the debt related to the upgrade of its wastewater treatment facilities and construction of new facilities to meet the wastewater effluent limits in its wastewater discharge permits issued by the Virginia Department of Environmental Quality ("DEQ").

On April 12, 2001, Dale Service filed a Petition for Waiver of Rate Case Filing Requirements ("Petition") in which it requested that the Commission waive its Rules Governing Utility Rate Increase Applications[1] that require the filing of "jurisdictional" schedules.

On June 27, 2001, after discussions with the Staff, Dale Service filed its Amended Application in which it requested a phase-in of the proposed increased rates. Specifically, Dale Service asked for a Phase 1 increase of $1,835,433 to be effective, subject to refund, as of October 1, 2001, and for a Phase 2 increase of no more than $2,521,455 to be effective, subject to refund, as of October 1, 2002. For Phase 1, Dale Service proposed to increase current quarterly rates of $40.80 for residential customers and $51.00 for commercial units to $63.00 and $80.00, respectively.

On July 12, 2001, the Commission issued an Order for Notice and Hearing. In this order, the Commission directed the Company to give notice of its application; established a local public

[1] 20 VAC 5-200-30 *et seq.*

hearing on September 24, 2001; set the public evidentiary hearing for September 18, 2002; authorized Phase 1 rates to become effective, subject to refund, on or after October 1, 2001; adopted a procedural schedule for the case; and assigned the matter to a hearing examiner.

On July 24, 2001, the Commission issued an Amending Order, in which it directed that the public hearing scheduled for September 24, 2002, convene at both 2:00 p.m. and 7:00 p.m. in the Board Chambers Room of the James J. McCoart Administration Building, 1 County Complex Court, Prince William, Virginia 22192.

On August 1, 2001, Dale Service filed a Motion to Amend Order for Notice and Hearing. In this motion, the Company requested that the Commission extend the date by which its newspaper publication must be completed from July 27, 2001, to August 3, 2001. A Hearing Examiner's Ruling dated August 2, 2001, granted Dale Service's Motion to Amend Order for Notice and Hearing.

On September 24, 2001, local public hearings were held as scheduled in the Board Chambers Room of the James J. McCoart Administration Building, Prince William, Virginia. Six public witnesses appeared during the 2:00 p.m. hearing, and two public witnesses presented testimony during the 7:00 p.m. hearing.

During the course of this case, several individuals filed written comments with the Commission. The written comments received by the Commission are summarized in the following table:

Date of Comments	**Name of Commentator**	**Summary of Comments**
April 17, 2001	Melanie Gursky	Complained that the drastic increase creates a financial burden for customers.
September 5, 2001	John D. Jenkins, Neabsco District Supervisor	Opposed the increase and supplied a resolution of the Board of Supervisors requesting that the proposed increase be both postponed and denied.
September 5, 2001	Mary K. Hill, Coles District Supervisor	Opposed the increase and supplied a resolution of the Board of Supervisors requesting that the proposed increase be both postponed and denied.
October 15, 2001	John J. Wendland, Jr.	Asked for the Staff to investigate the proposed rate increase.
October 16, 2001	Salvatore F. Biscardi	Objected to funding expansions, paying more for sewer than water service, and paying more than customers in other states.
November 20, 2001	Pete Ramos	Complained of a lack of notice of the proposed rate increase.
December 1, 2001	Foye L. Brewer	Recommended that builders be charged higher fees and that bills be tied to actual water usage.
December 3, 2001	Joseph C. Shu	Protested the rate increase and lack of public notice.
January 12, 2002	Simon Morgan	Requested that the Commission deny the increase request, which he described as exorbitant, unfair,

		and unreasonable.
January 13, 2002	Wayne J. Tiso	Asked the Commission to reject the increase, increase charges for commercial customers, and require billing based on actual usage.
January 14, 2002	Martin S. Pervin	Requested that the Commission consider current economic conditions and permit competitive companies to offer the same services.
January 14, 2002	Jeanne R. Stotler	Protested the rate increase. Complained of poor service and sewage backups.
January 14, 2002	Linda L. Green	Observed that the proposed increase is larger than the increase in pay, cost of living, and corporate earnings. Dale Service is just greedy.
January 14, 2002	K. D. Rogers	Contended that service has not improved, but cost has increased. Would like more of an explanation for the increase.
January 14, 2002	Wayne Shifflett	Stated that Dale Service failed to notify him of the increase and he was confused as to the proper rate.
January 14, 2002	Sally J. Borman	Asserted that the increases are exorbitant when compared to increases in retirement income. Also, Ms. Borman advocated measured service.
January 14, 2002	Terry Lawver	Found the proposed increase totally without merit or true justification.
January 15, 2002	Steven Chucala	Challenged the proposed increase, which he found to be an illegal tax.
January 15, 2002	Mrs. William G. Ludwig	Registered her dissatisfaction with the increase and described the difficulty of the increase on seniors.
January 15, 2002	Denise A. Richardson	Expressed dissatisfaction with the increase. In addition, she recommended metered service.
January 16, 2002	David McNichol	Stated that $40.80 to $63.00 is too steep an increase at one time.
January 16, 2002	Nadeen N. Mian	Opposed the increase, which she considered unjustified and unreasonable.
January 16, 2002	L. A. Williams	Expressed concern and objection to the drastic increase.
January 16, 2002	John E. Finorhietti	Strongly opposed the “future” increase to $94.00.
January 18, 2002	Brooke H. Wilson	With a 3% increase in pay per year it will take 18 years to catch up. She doubts this will affect the Potomac or Bay.
January 19, 2002	Morris Orlando	Stated that the Phase 1 increase of about 52% was much larger than the 2.6% increase in social security he received. Asked that the Phase 2 increase be disallowed.
January 16, 2002	Francisco E. Chavez	Questioned the need for customers to pay for the increase if it is funded through bonds, grants, and Company investments.
January 22, 2002	Wahidella Hashima	Protested the rate increase and recommended

		billing based on measured service.
January 24, 2002	Charles J. Colgan, Virginia State Senate	Forwarded correspondence from constituent, Brooke Wilson, who opposed the increase. Senator Colgan also requested an explanation of the dramatic rate hike increase.
January 24, 2002	Stanley R. Rupert	Commented that the proposed increase is not justified. Advocated a quarterly increase of only $6.75.
January 26, 2002	Sandra Newsome	The cost of government mandated improvements should be paid by those government organizations.
January 29, 2002	Vic Giarratano	Found the proposed increase outrageous. Lack of storm drainage, no street lighting, and poor street maintenance are more important than the Bay.
February 1, 2002	Jimmy Lee Wallace	Expressed complete dissatisfaction with the rate increase. Virginia's taxes are too high and state funds should be used to make the upgrades.
February 17, 2002	Margaret Gulledge	Protested the increase in rates and complained of no prior notice served on the public.
February 18, 2002	Ron and Angela Fortune	Understand the upgrades are necessary but argue the proposed increase was drastic and unexpected. Commercial customers should pay more.
February 20, 2002	Petition of 118	Opposing the proposed increase.
February 22, 2002	Richard W. Dew	Strongly objected to the increase and stated that builders should pay for over-crowding the system.
February 28, 2002	Jim Virgil	Protested any increase. Growth should take care of additional costs. Consumers should not bear the burden of EPA environmental regulations.
March 21, 2002	Vikram K. Gupta	Submitted that current rates are too high and should not be raised.
March 22, 2002	Lawrence E. Nelson	Expressed deep concern and dissatisfaction with the "PHASED" increase. Such an increase requires closer scrutiny by the Commission.
May 6, 2002	Karen T. Pratzner	Asked that bills be based on actual usage and requested an evening hearing to permit public participation.
May 17, 2002	Dennis M. Murphy	Described the increase as arbitrary. Asked for a local hearing and urged the Commission to reject the "astronomical" increase.
May 20, 2002	Kevin Raymond	Stated that affiliate companies should be required to pay some or all of the capital costs.
May 23, 2002	Miriam B. Young	Argued that people on fixed incomes should not pick up the tab for large corporations.
May 24, 2002	Alicia L. Johnson	Requested more information about why rates are increasing.
May 29, 2002	Patricia M. Mantoan, Esq.	Protested that the magnitude of the increase is unprecedented and outrageous and should be

		rejected by the Commission.
June 12, 2002	Lisa A. Lurty	Characterized the increase as robbing the general public dry.
June 13, 2002	Robin Rogan	Questioned the need and timing of the increase in rates, and complained of a lack of notice. Submitted that there should be more difference between residential and commercial rates.
June 15, 2002	Renay and Ray Panone	Found the steep jump in price unacceptable. Asked that the Commission consider the elderly, single mothers, widows, and those on fixed incomes.
June 24, 2002	William H. Westhoff	The improvements and added capacity should be paid for by shareholders. Also, the increase for residential customers is inequitable compared to commercial customers. Company provides poor service.
June 28, 2002	Teresa Harvey	Objected to the increase, which would be highway robbery.
June 28, 2002	Cynthia Lee	Objected to the increase, which would be highway robbery.
July 4, 2002	Sandra McCreesh	Opposed the increase and recommended re-evaluation of costs.
July 18, 2002	Katrena Moody	Expressed displeasure with the overwhelming increase and complained about the way the bill for her business was calculated.
July 19, 2002	John Kronebusch	Opposed the rate increase. Recommended increasing the charges for new sewer hookups.
September 5, 2002	John D. Jenkins, Neabsco District Supervisor	Requested that the evidentiary hearing scheduled for September 18, 2002, be moved to Prince William.
September 13, 2002	Michèle B. McQuigg, House of Delegates	Requested that the hearing be moved from Richmond to Prince William County.

On June 5, 2002, Dale Service filed a Motion for Leave to file Corrected Supplemental Application and Testimony. In its Corrected Supplemental Application, the Company requested confirmation of the procedural schedule set forth in Order for Notice and Hearing, and asked to be directed to publish notice of the Phase 2 rates, which it now requested to be set at $86.75 per quarter for residential service and $113.00 per quarter for commercial units. A Hearing Examiner's Ruling dated June 5, 2002, granted the Company's Motion. Additional notice was directed in a Hearing Examiner's Ruling dated August 29, 2002.

On September 18, 2002, the evidentiary hearing was convened as scheduled. Richard D. Gary, Esquire, and Renata M. Manzo, Esquire, appeared on behalf of Dale Service. Joseph W. Lee, Esquire, represented the Staff. One public witness appeared at the evidentiary hearing. A Stipulation, executed by the Company and Staff and designed to resolve all of the issues in this case, was presented at the hearing. The Stipulation is provided as Attachment No. 1. Filed with this Report are transcripts of the hearings.

SUMMARY OF THE RECORD

Dale Service's current rates were approved in 1986.[2] According to the Company, it is currently upgrading its wastewater treatment facilities and constructing new facilities in order to meet the wastewater effluent limits, which took effect April 3, 2002.[3] In its Application, Dale Service estimated the cost of these upgrades and construction to be $32,388,135.[4]

Dale Service supported its requested rate increase with the testimony of three witnesses – Norris L. Sisson, president of Dale Service; Peter M. Loomis, project engineer for Parsons Engineering Science, Inc. ("Parsons"); and Burnice C. Dooley, partner with the firm of Dooley & Vicars. Mr. Sisson described the overall operations of the Company, and explained its current and proposed rate structures.[5] In addition, Mr. Sisson justified the proposed increase and the need for the construction and upgrades.[6] Mr. Sisson stated that without the proposed increase, Dale Service's "operating revenues will be inadequate to cover the increased operating expenses, debt service, annual cost associated with the debt and maintain a 1.15 to 1 debt coverage ratio required by the lender."[7] Thus, the case revolves around the need for the construction and upgrades.

Mr. Sisson testified that in 1996 the General Assembly enacted legislation that required the Secretary of Natural Resources to develop strategies specific to each Chesapeake Bay tributary to reduce nutrients and suspended solids.[8] In 1997, the Potomac Tributary Nutrient Reduction Strategy was developed and called for a 40% reduction in the amount of nitrogen and phosphorus from the Company's wastewater treatment plants.[9] In June of 1998, the DEQ reissued Dale Service's Virginia Pollutant Discharge Elimination System ("VPDES") permits, which for the first time, set effluent limits for ammonia (as nitrogen) and set more stringent limits for Biochemical Oxygen Demand ("BOD") and total suspended solids ("TSS").[10] These new limits were scheduled to become effective on April 3, 2002.[11] Based upon a Preliminary

[2] *Application of Dale Service Corporation to revise tariffs*, Case No. PUE-1985-00041, 1986 S.C.C. Ann. Rep. 275.
[3] Application at ¶ 4.
[4] *Id.* at ¶ 5.
[5] Exhibit No. 5, at 2, 3-6.
[6] *Id.* at 6-11.
[7] *Id*. at 6.
[8] *Id.* at 7. *See*, Va. Code § 2.2-218.
[9] Exhibit No. 5, at 7.
[10] *Id.* at 7-8.
[11] *Id.* at 8.

Engineering Report prepared by Parsons, Dale Service determined that its existing treatment plants were unable to meet the new permit limits.[12]

Mr. Loomis further explained the upgrades and construction recommended by Parsons and sponsored the Preliminary Engineering Report.[13] According to Mr. Loomis, prior to the upgrades and construction, Dale Service operated two wastewater treatment plants, which eventually discharged treated wastewater into Neabsco Creek.[14] One of the plants was constructed in the mid 1960's and was expanded to its current capacity in the early 1970's.[15] The other plant was constructed about 1970.[16] Because the existing plants were built to meet less stringent permit limits and used dated technology, Dale Service undertook the following actions to meet current permit limits:

> (a) upgrades to the headworks for both screening and degritting;
> (b) conversion of the existing contact stabilization tanks to provide flow equalization and increased aerobic digestion capacity;
> (c) upgrades to the tertiary clarifiers; (d) installation of new filtration systems; (e) upgrades to the existing ultraviolet (UV) disinfection systems; (f) upgrades to the sludge thickening and dewatering systems; and (g) improvements to protect the site from a 100-year flood event.[17]

In addition to meeting the current permit limits, Mr. Loomis confirmed that the capacity of the system was increased from 4.2 million gallons per day ("MGD") to accommodate a projected ultimate flow of 8.0 MGD, based on current population growth projections.[18]

Mr. Dooley sponsored several accounting and financial related schedules in the Company's Application including Schedule 3 (Capital Structure), Schedule 8 (Proposed Capital Structure), Schedule 15 (Rate of Return Statement), Schedule 16 (Rate Base), Schedule 17 (Explanation of Adjustments), Schedule 18 (Reconciliation of Revenue Requirement Shortfall), and Schedule 31 (Proposed Rates).[19] Dale Service used the twelve months ended December 31, 2000 as its test year.[20] Mr. Dooley showed that during the test year, Dale Service had net income of $713,227.[21] However, Mr. Dooley offers a series of adjustments to reflect rate year levels of activities that reduce net operating income by $4,134,550.[22] Based on these adjusted test year results, Mr. Dooley calculates that in order to earn a 10.75% return on equity,

---

[12] *Id.* at 9.
[13] Exhibit 6, at 1.
[14] *Id.* at 2.
[15] *Id.* at 3.
[16] *Id.*
[17] *Id.*
[18] *Id.* at 7.
[19] Exhibit No. 7, at 1.
[20] *Id.*
[21] *Id.* at 3, Schedule 15, line 23.
[22] *Id.*

Dale Service requires an increase in annual revenues of $4,356,888.[23] Mr. Dooley submitted that the proposed increase would also permit the Company to achieve a debt service coverage ratio of 1.23.[24]

During the public hearing held on September 24, 2001, eight public witnesses offered testimony.

Michele B. McQuigg, a member of the Virginia House of Delegates, recognized that the environmental requirements Dale Service must meet are important for protecting water quality and the environment.[25] Delegate McQuigg acknowledged that the environmental requirements Dale Service must meet are not inexpensive.[26] Nonetheless, Delegate McQuigg expressed the hope that the Commission will determine that a smaller increase can fund the required changes and that it can be phased in to make the increase easier for citizens to absorb.[27]

John D. Jenkins, Neabsco District Supervisor for Prince William County and a customer of Dale Service, described frequent complaints he receives from customers regarding odors that emanate from the treatment plants located behind the Center Shopping Plaza and the Ashdale Shopping Center.[28] In addition, Supervisor Jenkins explained that he opposes the excessiveness of the proposed increase of 130%.[29] Supervisor Jenkins expressed concern that without a significant tap fee, existing customers will bear the cost of infrastructure improvements necessary to serve future or new customers.[30]

Mary K. Hill, Coles District Supervisor for Prince William County, expressed concern regarding the magnitude of the rate increase.[31] Supervisor Hill was dismayed equally by the proposed phase-in approach.[32] She echoed Supervisor Jenkins' testimony regarding odors and failure to collect appropriate tap fees.[33] In summary, Supervisor Hill asked the Commission to arrive at a conclusion in this case, which allows the proper operation of the Company, fully weighs the needs of all its customers, and also protects the environment.[34]

Edith Feigenbaum, resident of Dale City, described that she lives across from Plant No. 8 and has experienced very bad odors from Plant No. 8 on several occasions.[35] Ms. Feigenbaum

[23] *Id.* at 3, Schedule 15, line 1 and 32.
[24] *Id.* at 9.
[25] McQuigg, Tr. at 5.
[26] *Id.*
[27] *Id.* at 6.
[28] Jenkins, Tr. at 8.
[29] *Id.* at 9.
[30] *Id.* at 9-10.
[31] Hill, Tr. at 12.
[32] *Id.* at 13.
[33] *Id.*
[34] *Id.* at 14.
[35] Feigenbaum, Tr. at 15-16.

opposed the requested increase.[36] Ms. Feigenbaum advised there are many people, like herself, that are on small incomes and cannot afford the increase.[37]

Paul Barr, a Dale Service customer, testified that he had no problem with a rate increase after fifteen years.[38] Nonetheless, Mr. Barr recommended that the proposed increase be phased in over a three-year period.[39] Mr. Barr believed that a three-year phase-in period was more controlled and should be acceptable to the Company.[40]

Groveton Adams, a resident of Dale City, testified that he was opposed to the Company's proposed rate increase.[41]

James J. Fullem, a resident of Dale City, objected to the amount of this increase, which he described as "obscene."[42] Mr. Fullem questioned what the Company has done with the money they have been receiving for years.[43] Mr. Fullem maintained that Dale Service should have been planning for the future and planning for expansion.[44] Mr. Fullem advised the Commission to send the Company's Application back and have them ask for only what is needed.[45]

Abdul R. Kamara, a resident near Plant No. 8, complained of the terrible odor.[46] Mr. Kamara hoped the Commission could make sure that odor is not a problem in the future.[47]

On June 3, 2002, Dale Service filed its Supplemental Application, including the additional direct testimony of Mr. Sisson.[48] On June 5, 2002, the Company filed a Corrected Supplemental Application and the corrected additional direct testimony of Mr. Sisson.[49] In its Corrected Supplemental Application, Dale Service set its requested Phase 2 annual rate increase at $2,106,885.[50] This increase was scheduled to go into effect, subject to refund, on October 1, 2002.[51] Thus, Dale Service proposed quarterly Phase 2 rates of $87.75 for residential customers and $113.00 for commercial customers.[52] In his corrected additional direct testimony,

---

[36] *Id.* at 16.
[37] *Id.* at 16-17.
[38] Barr, Tr. at 19.
[39] *Id.* at 19-20.
[40] *Id.* at 20.
[41] *Id.* at 21-22.
[42] *Id.* at 25.
[43] *Id.*
[44] *Id.* at 25-26.
[45] *Id.* at 26.
[46] *Id.* at 27.
[47] *Id.*
[48] Exhibit No. 8.
[49] Exhibit No. 9.
[50] Corrected Supplemental Application at ¶ 8.
[51] *Id.*
[52] *Id.*

Mr. Sisson explained that the Company expected to have both units fully operational no later than September 1, 2002, and that the DEQ had granted Dale Service an extension on its new effluent limits until October 1, 2002.[53] In addition, Mr. Sisson testified that the difference between its original not-to-exceed Phase 2 proposed annual increase of $2,521,455 and its revised request for $2,106,885 reflected the lower revenue requirement necessary to cover the debt service and operating cost of the new units.[54]

On August 22, 2002, Staff filed the testimony of Scott C. Armstrong, principal public utility accountant with the Division of Public Utility Accounting; John R. Ballsrud, principal financial analyst with the Division of Economics and Finance; and Gregory L. Abbott, utilities analyst with the Division of Energy Regulation.

Mr. Armstrong offered up-front corrections to the Company's per book amounts, presented Staff's analysis of fully adjusted earnings, and made other accounting recommendations.[55] Mr. Armstrong testified that because Staff has conducted no recent formal accounting evaluation, he discovered several items that required revision to conform with the Uniform System of Accounts for Class A Wastewater Utilities.[56] These up-front corrections included: (i) capitalization of payroll and related benefits associated with construction projects;[57] (ii) capitalization of the cost of a new computer system and the cost of preparation of topographical maps of its service territory;[58] (iii) application of a composite annual depreciation rate of 3%;[59] (iv) amortization and accumulated amortization of contributions in aid of construction ("CIAC");[60] (v) correction of deferred taxes;[61] and (vi) removal of deferred sludge removal costs.[62] Mr. Armstrong reported that Dale Service adopted and booked Staff's up-front adjustments.[63]

In his discussion of Staff's analysis of fully adjusted earnings, Mr. Armstrong explained that Staff used the Company's 2000 test year as a basis for Phase 1 and adjusted certain operating costs for rate year changes based upon actual results for October 2001 through June 2002, with the June 2002 amounts annualized for the remaining three months of Phase 1.[64] Mr. Armstrong noted that for customer counts, rate base, and rate base-related items, Staff used average actual data through July 26, 2002, in order to provide the Commission with the most recent information available in light of the substantial portion of the Company's upgrade project

---

[53] Exhibit No. 9, at 2.
[54] *Id.* at 3-4.
[55] Exhibit No. 12.
[56] *Id.* at 5.
[57] *Id.*
[58] *Id.* at 6.
[59] *Id.* at 6-7.
[60] *Id.* at 7-9.
[61] *Id.* at 9-13.
[62] *Id.* at 12.
[63] *Id.* at 5-13.
[64] *Id.* at 14.

that went into service during July 2002.[65] For Phase 2, Staff began with the 2000 test year and adjusted for rate year changes calculated by annualizing June 30, 2002, for certain operating costs. Staff used the July 26, 2002, update period level for customer count, rate base, and rate base-related items.[66] For example, for the Phase 1 customer count, Mr. Armstrong uses an average count through July 26, 2002, and an annualized count for July 26, 2002, through the end of the Phase 1 rate year on September 30, 2002.[67] For the Phase 2 customer count, Mr. Armstrong annualized the July 26, 2002, count.[68]

Mr. Armstrong incorporated an adjustment to reflect Staff's proposal that Dale Service discontinue connection fees and trunkline surcharges and instead institute a capacity charge for each new connection, which is designed to approximate the average of what customers over the past ten years have paid in combined connection fees and trunkline surcharges.[69] Mr. Armstrong calculated the Phase 2 going level annual capacity charge revenue by multiplying the proposed $1,800 capacity charge by 500 annual equivalent connections.[70] Mr. Armstrong based the 500 annual equivalent connections on the ten-year average of 464 and the annualized calendar year 2002 connections of 506.[71]

Absent a depreciation study prepared by Dale Service, Mr. Armstrong applied a 3% composite depreciation rate for all of the Company's plant in service, including the upgraded facilities.[72] Mr. Armstrong acknowledged that because of the importance of the Company's debt service coverage ratio ("DSC"), Dale Service may recover its investment in the new facilities within 20 years or less.[73] Thus, Mr. Armstrong recommended that CIAC applicable to the upgrade project not be amortized at this point, but be preserved for application against depreciation accruals taken on the upgrade plant after the DSC mechanism has effectively recovered all principal.[74]

Because of its speculative nature, Mr. Armstrong proposed that no property tax expense for the new sewage treatment upgrade facilities be included in the Company's cost of service.[75] Nonetheless, Mr. Armstrong included an adjustment of $78,949 for the Phase 2 rate year increase for property tax based upon Prince William County's estimated assessment grossed down by the same ratio that the test year original assessment was revised downward.[76] Similarly, Mr. Armstrong indicated that Staff was uncomfortable with Dale Service's anticipated

[65] *Id.* at 14-15.
[66] *Id.* at 15.
[67] *Id.* at 17.
[68] *Id.*
[69] *Id.* at 18.
[70] *Id.*
[71] *Id.*
[72] *Id.* at 20.
[73] *Id.* at 21-22.
[74] *Id.* at 22-23.
[75] *Id.* at 23.
[76] *Id.* at 24.

increases in both the demand for and cost per pound of chemicals.[77] However, Mr. Armstrong adjusted the Company's estimated increase in chemical expenses for estimated increased use of magnesium hydroxide by applying a ratio based on actual flows divided by ultimate flows.[78]

In addition to the adjustments discussed above, Mr. Armstrong offered, described, and supported Staff's adjustments to electricity expense,[79] testing expense,[80] payroll and payroll related items,[81] ultra-violet light replacement and pump building expense,[82] industrial revenue bond issuance cost,[83] grant receipts and grant application costs,[84] and rate case costs.[85]

Based on the adjustments sponsored by Mr. Armstrong and the capital structure and return components supported by Staff witness Ballsrud, Mr. Armstrong determined that implementation of the $1,835,433 in additional annual revenues on October 1, 2001, results in a fully adjusted income available for common equity of $209,149.[86] This yields a 5.23% return on common equity and a 0.69 debt service ratio.[87] Based on these results, Mr. Armstrong concluded that the Phase 1 revenue increase was not excessive.[88]

For Phase 2, Mr. Armstrong found that in order to achieve a 1.15 debt service ratio, Dale Service required an additional annual revenue increase of $1,344,394 above the Phase 1 increase, or a total increase of $3,179,827.[89] Such an increase produces $583,219 of income available for equity, or a 14.35% return on equity.[90]

Furthermore, Mr. Armstrong recommended that Dale Service be required to make Annual Informational Filings ("AIFs") with the Commission in years that it does not seek a change in rates, beginning with the 2002 calendar year. Included in its AIFs should be a schedule that tracks the sewage treatment upgrade project costs, retirements, associated CIAC, cumulative depreciation, and the annual principal payments on bonds.[91] Further, Mr. Armstrong asked the Commission to direct Dale Service to prospectively book any connection fees, trunkline surcharges, or capacity charges collected after October 1, 2002, as revenue; amortize rate case costs from this case over a three-year period; and maintain its books and accounting

[77] *Id.* at 25.
[78] *Id.* at 25-26.
[79] *Id.* at 26-27.
[80] *Id.* at 27.
[81] *Id.* at 27-28.
[82] *Id.* at 28.
[83] *Id.* at 29.
[84] *Id.*
[85] *Id.* at 30.
[86] *Id.* at 31.
[87] *Id.*
[88] *Id.*
[89] *Id.*
[90] *Id.*
[91] *Id.* at 32.

records in conformance with the Uniform System of Accounts for Class A Wastewater Utilities.[92]

Staff witness Ballsrud addressed capital structure, cost of equity, and Dale Service's DSC.[93] Mr. Ballsrud proposed a capital structure comprised of 21.46% equity and 78.54% debt.[94] Mr. Ballsrud computed this capital structure by taking a simple average of the Company's capital structures on December 31, 2001, and the Company's estimated capital structure as of December 31, 2002.[95]

To calculate the cost of equity, Mr. Ballsrud conducted a discounted cash flow ("DCF") analysis and employed several risk premium methodologies using market data through July 2002.[96] Based on these studies, Mr. Ballsrud concluded the cost of equity for Dale Service to be in the range of 9.75% to 10.75%.[97] However, Mr. Ballsrud testified that existing covenants in the Company's loan agreements require a minimum DSC ratio of 1.15 to 1.00.[98] Because of these covenants and Dale Service's "extremely high degree of financial leverage," Mr. Ballsrud recommended a 14.35% return on equity, which would provide the Company with an opportunity to achieve a DSC ratio of 1.15.[99]

Finally, Mr. Ballsrud commented that over the next few years, Dale Service may be able to significantly lower interest costs and provide the Company with the opportunity to lower its rates.[100] Thus, Mr. Ballsrud urged Dale Service officials to explore ways to reduce rates voluntarily in the coming years if capital costs decline.[101]

Staff witness Abbott testified concerning rate design and Staff's proposed changes to the Rules and Regulations section of the Company's tariff.[102] Because Dale Service requires developers or property owners to make physical connection to the Company's system at the developer or property owner's expense, Mr. Abbott took the position that connection fees charged by Dale Service should be eliminated.[103] In addition, Mr. Abbott recommended elimination of the $2,500 trunkline fee per service connection that Dale Service collects for connections along mains where the Company paid for the construction of the mains up-front.[104] In its place, Mr. Abbott recommends that future residential and commercial customers pay a

[92] *Id.*
[93] Exhibit No. 13.
[94] *Id.* at 6.
[95] *Id.*
[96] *Id.* at 1, 10-21.
[97] *Id.* at 2, 21.
[98] *Id.* at 2.
[99] *Id.*
[100] *Id.* at 22.
[101] *Id.* at 23.
[102] Exhibit No. 14.
[103] *Id.* at 9.
[104] *Id.*

capacity charge of $1,800 which is designed to recover the cost of new capacity added as part of the upgrade project.[105]

Other recommendations made by Mr. Abbott are as follows:

- The Company should be required to adopt Staff's methodology for truing-up the number of taps used to determine the quarterly billing for commercial customers;

- The Company should be required to inform, in writing, each commercial customer of the mechanism used to calculate the number of taps and the amount of water usage currently used to estimate each customer's bill. This should be required at a date to be determined by the Commission and no less than biannually after that date; and

- Staff's recommended tariff language contained in Exhibit No. 14, Appendix B should be approved.[106]

Based on its analysis, adjustments, and recommendations, Staff proposed the quarterly residential and commercial Phase 1 rates to be $63.00 and $80.00, respectively, and the quarterly residential and commercial Phase 2 rates to be $67.75 and $85.75, respectively.[107]

On September 5, 2002, Dale Service filed the rebuttal testimony of Messrs. Sisson and Dooley. Mr. Sisson addressed five issues. First, Mr. Sisson expressed concern with Staff's recommendation that rates be designed precisely to meet the 1.15 DSC ratio.[108] Mr. Sisson argued Staff's proposal created financial risk by leaving no margin for error or in the event anticipated revenues fail to materialize.[109] Thus, Mr. Sisson advocated basing rates on a 1.20 DSC ratio, which would provide the Company a revenue cushion of $175,000, or about 0.05676% of the annual revenue requirement.[110]

Second, Mr. Sisson maintained that Staff's adjustment for property taxes failed to consider a letter from Prince William County estimating the 2003 assessments for each one of the parcels to be in the range of $12 million to $14.5 million.[111] Because the cost of construction is estimated to be $32 million and fair market value will likely be based on the cost of construction, Mr. Sisson contended "it is inevitable – not speculative – that the Company is going to pay more in property taxes starting in 2003."[112] Moreover, Mr. Sisson emphasized that previous adjustments to property assessments made by Prince William County were at the

[105] *Id.* at 10-12.
[106] *Id.* at 17-18.
[107] *Id.* at 12.
[108] Exhibit No. 10, at 2.
[109] *Id.*
[110] *Id.* at 3.
[111] *Id.* at 4.
[112] *Id.*

Company's request and for old, existing facilities.[113] Mr. Sisson asserted such adjustments by Prince William County would be unnecessary for the newly constructed project.[114]

Third, while Mr. Sisson agreed that the projected price increase for chemicals has not materialized, he insisted that Dale Service is required to use additional chemicals, such as magnesium hydroxide, in its new facilities.[115] In addition, Mr. Sisson stated that beginning July 2002, the Company began using a new polymer for sludge processing.[116] Mr. Sisson calculated the net increase in chemical cost to be $195,774 for Phase 2.[117]

Fourth, Mr. Sisson disputed the reasonableness of Staff's estimate of 500 new connections per year.[118] He contended the 897 connections experienced in 2001 skew Staff's historic annual average.[119] Mr. Sisson pointed out that there are only 3,000 undeveloped lots remaining in Dale City and that during the first eight months of 2002, Dale Service received only 239 tap fees.[120] Therefore, Mr. Sisson argued that based on the number of connections that have occurred during the most recent twelve months, 325 is a more realistic number to use for annual connections.[121]

Finally, Mr. Sisson responded to Staff's proposed changes in tariff language. Mr. Sisson offered several changes to make the language more applicable to sewerage treatment facilities.[122] Other differences relate to: (i) the specificity of the list of materials prohibited from being discharged into the Company's sewerage system;[123] (ii) the allocation of responsibilities between the Company and the customer regarding backups in the sewerage treatment lines;[124] (iii) the determination of "satisfactory credit" concerning customer deposits;[125] (iv) the required number of days for written notice before discontinuing service;[126] and (v) the ownership and maintenance responsibilities for pumping stations.[127]

Mr. Dooley provided revised revenue requirement calculations based on the adjustments supported by Mr. Sisson.[128] In addition, Mr. Dooley described an agreement with Staff to use a

[113] *Id.* at 5.
[114] *Id.* at 5-6.
[115] *Id.* at 6.
[116] *Id.*
[117] *Id.* at 7.
[118] *Id.*
[119] *Id.* at 8.
[120] *Id.*
[121] *Id.*
[122] *Id.* at 10-11.
[123] *Id.* at 11-12.
[124] *Id.* at 12.
[125] *Id.*
[126] *Id.* at 12-13.
[127] *Id.* at 13.
[128] Exhibit No. 11, at 1-4.

5% depreciation rate on the newly constructed plant assets.[129] Finally, Mr. Dooley pointed out that Staff's proposal to treat capacity charges as revenue rather than CIAC means that approximately 39% of the amount collected will go to pay taxes rather than to pay debt principal.[130] Based on these changes, Mr. Dooley computed the Phase 2 quarterly rate for residential customers to be $76.46 and the Phase 2 quarterly rate for commercial customers to be $95.57.[131]

At the hearing held on September 18, 2002, Katrena Moody, owner of a barbershop/beauty salon served by Dale Service, appeared as a pubic witness.[132] Ms. Moody described the difficulty she experienced when she tried to get someone to explain how the bill for her business was calculated.[133] Ms. Moody testified that John Stevens of the Staff answered her inquiry and informed her that business was billed based on the number of taps, which is determined by water usage, *i.e.* 84,000 gallons for each tap.[134] Ms. Moody stated that her business is billed for five taps, but she has never used that level of water in the six years she has operated her business.[135] Ms. Moody estimated that she has been over-billed by $5,000.[136] More specifically, from 1996 until October 2001, Ms. Moody claimed that she was billed $255 per quarter, when she should have been billed $51 per quarter.[137] Further, Ms. Moody asserted starting in October of 2001, she was billed $400 a quarter, but should have been billed only $80 a quarter.[138] Ms. Moody reported that Dale Service has offered to refund some of the over-billed amounts.[139] However, Ms. Moody has been unhappy with the Company's offers and testified that she seeks "a settlement of the amount that they owe me, with interest, and for there to be a refund, where I'm not responsible for any taxes, and if anything else comes of these litigations, I want to be a part of the group of individuals and also receive compensation for that."[140] Ms. Moody indicated that she knew of other businesses that are being overcharged.[141] Thus, Ms. Moody insisted that business owners be given more information about how their bills are calculated and customers be given a process by which their bills would be determined based upon actual water usage.[142]

In addition, at the hearing held on September 18, 2002, Dale Service and Staff (collectively, "Stipulating Parties") offered a Stipulation designed to resolve all of the issues

[129] *Id.* at 4.
[130] *Id.* at 3.
[131] *Id.* at 5.
[132] Moody, Tr. at 45-54.
[133] *Id.* at 46.
[134] *Id.* at 47.
[135] *Id.* at 47-48.
[136] *Id.* at 48.
[137] *Id.* at 49.
[138] *Id.* at 49-50.
[139] *Id.* at 48.
[140] *Id.* at 50.
[141] *Id.* at 50-51.
[142] *Id.* at 52-53.

between the Company and Staff.[143] The Stipulating Parties agreed that the Phase 1 rates, which commenced on October 1, 2001, shall be deemed to have been just and reasonable and not subject to refund.[144] The Stipulating Parties agreed to Staff's proposed Phase 2 adjustments, subject to the following modifications: (i) the property tax adjustment amended to incorporate an update to the property assessment by Prince William County;[145] (ii) the chemical expense adjustment revised to include projected usage of magnesium hydroxide;[146] (iii) revenue for Staff's proposed capacity charge will be based upon 400 new service connections;[147] (iv) depreciation on the portion of the new facilities supported by bonds shall be calculated on a 20-year amortization schedule until otherwise ordered by the Commission;[148] and (v) revenue requirements will be calculated based upon a 1.20 DSC.[149] With these changes, the Stipulating Parties agreed upon quarterly rates of $73.75 for residential customers and $92.60 for commercial units.[150]

Furthermore, the Stipulating Parties agreed that Dale Service shall be required to inform commercial customers not less than once every three years, of the formula used to determine their service charge.[151] Dales Service shall be subject to the Commission's AIF requirements beginning with calendar year 2003.[152] If the Company receives more than 400 capacity charges ("excess capacity charges") in any test year, Dale Service agreed to impute interest income on the excess capacity charges as a going-forward adjustment, but the excess capacity charges will not be considered as operating revenues for ratemaking purposes.[153] If Dale Service were to obtain additional governmental grants related to the new facilities, it will report such grants to the Commission and initiate discussions with the Staff regarding the ratemaking effect of such grants.[154]

Finally, the Stipulating Parties agreed that the Stipulation shall expire upon the final order of the Commission in Dale Service's next rate case.[155] Taken as a whole, the Stipulating Parties maintained that the resolution of the issues in the Stipulation is in the public interest.[156] The Stipulating Parties conditioned the Stipulation "on and subject to acceptance by the Commission and is non-severable and of no force or effect and may not be used for any other purpose unless

[143] Exhibit No. 15.
[144] Exhibit No. 15, at ¶ 3.
[145] *Id.* at ¶ 4 A.
[146] *Id.* at ¶ 4 B.
[147] *Id.* at ¶ 4 C.
[148] *Id.*
[149] *Id.* at ¶ 4 D.
[150] *Id.* Attachment B, at 3.
[151] *Id.* at ¶ 6.
[152] *Id.* at ¶ 7.
[153] *Id.* at ¶ 8.
[154] *Id.* at ¶ 9.
[155] *Id.*
[156] *Id.* at ¶ 10.

accepted in its entirety by the Commission, except that this paragraph shall remain in effect in any event."[157] A copy of the Stipulation is provided as Appendix A to this report.

DISCUSSION

Based on Dale Service's Application and Supplemental Application, and based upon a review of the record, I find that the Stipulation offers a reasonable and just resolution to all of the issues in this case. The Stipulation provides Dale Service with an opportunity recover its cost of service and meet its debt service obligations associated with its new treatment facilities. Institution of Staff's proposed capacity charge addresses the concern raised by public officials regarding current customers paying for new capacity to serve new customers. Inclusion of revenue from the collection of the proposed capacity charge from anticipated new customers in the ratemaking revenue requirement calculation, assures that current customers do not bear the entire cost of the of the new treatment facilities. Further, Dale Service's commitment to make AIF filings provides the Commission with the opportunity to review the reasonableness of the Company's rates and to respond to changes in circumstances.

Moreover, the Stipulation's agreement to insert tariff language requiring Dale Service to inform commercial customers in writing of the formula used to determine the number of units answers some of the complaints raised by public witness Moody. This tariff provision provides a description of the formula used and requires Dale Service to obtain actual water usage data. More specifically as to this latter point, the Stipulating Parties agreed to the following language:

> As a condition to obtaining service, the Customer shall provide the Company with permission to obtain the Customer's actual water usage data periodically as required in these Rules and Regulations. At the end of the first twelve months of service, the Company shall obtain the Customer's actual water usage for the previous twelve months and adjust the Customer's service charge going forward in accordance with the actual number of taps determined from the Customer's actual water usage during the previous twelve months. In no event shall the Company be allowed to make additional charges to the Customer retroactively for the previous twelve months of service if the Customer's actual water usage during the previous twelve months was higher than the estimated amount, or be required to issue a refund to the Customer if the Customer's actual water usage during the previous twelve months was lower than the estimated amount.[158]

While the proposed tariff language fails to resolve the level of refund, if any, due Ms. Moody, the tariff appears designed to keep such situations from occurring in the future. Therefore, based on the above discussion, I find that the Stipulation should be adopted.

---

[157] *Id.* at ¶ 11.
[158] Exhibit No. 15 Attachment B, at 3.

FINDINGS AND RECOMMENDATIONS

In conclusion, based on the evidence received in this case, I find that:

(1) The use of a test year ending December 31, 2000, is proper in this proceeding;

(2) Dale Service's Phase 1 operating revenues, after all adjustments, were $3,437,612;

(3) Dale Service's Phase 1 operating expenses, after all adjustments, were $3,264,093;

(4) Dale Service's Phase 1 net operating revenues, and adjusted net operating income, after all adjustments were $173,519 and $171,219, respectively;

(5) Dale Service's current rates produce a return on Phase 1 adjusted rate base of 0.92%, a DSC ratio of 0.18, and a return on common equity of -23.18%;

(6) Dale Service's Phase 1 adjusted rate base is $18,628,487;

(7) Based on the Stipulation, Dale Service requires $1,835,433 in additional gross annual revenues to earn a reasonable return on rate base. Thus, Dale Service's proposed Phase 1 rates are just and reasonable and should be made permanent for the Phase 1 rate period of October 1, 2001, through September 30, 2002;

(8) Dale Service's Phase 2 operating revenues, after all adjustments, were $3,474,142;

(9) Dale Service's Phase 2 operating expenses, after all adjustments, were $3,885,069;

(10) Dale Service's Phase 2 net operating revenues, and adjusted net operating income, after all adjustments were ($410,928) and ($413,505), respectively;

(11) Dale Service's current rates produce a return on Phase 2 adjusted rate base of -2.19%, a DSC ratio of 0.23, and a return on common equity of -37.25%;

(12) Dale Service's Phase 2 adjusted rate base is $18,905,199;

(13) Based on the Stipulation, Dale Service requires $3,501,934 in additional gross annual revenues to earn a reasonable return on rate base. Thus, the Phase 2 rates provided in the Stipulation are just and reasonable and should be made permanent for the Phase 2 rate period beginning October 1, 2002;

(14) Dale Service should be required to refund, with interest, all revenues collected under its interim Phase 2 rates in excess of the amounts found just and reasonable herein;

(15) Dale Service should be required to file AIFs with the Commission with its AIF for 2002 due no later than May 1, 2003. Dale Service should be required to include a

DSC calculation, fully adjusted, on a basis consistent with that utilized by the Staff in this proceeding and shall assume 400 new service connections, until otherwise agreed upon by the Company and Staff;

(16) If Dale Service's AIF calculates a DSC that exceeds 1.20, or if the Commission later adjusts Dale Service's AIF to produce a DSC above 1.20, Dale Service should be required to reduce its rates going forward as of the next quarterly billing to produce a 1.20 DCS;

(17) Dale Service should be required to implement a $1,800.00 capacity charge per new connection and treat such amounts as revenue. If in any test year Dale Service receives more than 400 capacity charges, Dale Service should be required to impute interest income on the capacity charges in excess of 400 as a going-forward adjustment to test year results, and not include such excess capacity charges as revenue for ratemaking purposes;

(18) Dale Services should be required to revise its tariff to include the rules and regulations set forth in Attachment B to the Stipulation, and maintain its books in accordance with the Uniform System of Accounts for Class C water utilities;

(19) Dale Service should apply a 5% depreciation rate to the portion of the new facilities supported by its bonds and shall apply a 3% composite rate to all other depreciable plant, CIAC, and any replacement plant; and

(20) Dale Service should be required to report promptly to the Commission the receipt of any additional grants related to the new facilities installed to comply with new environmental regulations and initiate discussions with the Staff as to the ratemaking effect of such grants.

In accordance with the above findings, ***I RECOMMEND*** the Commission enter an order that:

1. ***ADOPTS*** the findings in this Report;

2. ***GRANTS*** Dale Service an increase in gross annual revenues of $3,501,934; and

3. ***DISMISSES*** this case from the Commission's docket of active cases and passes the papers herein to the file for ended causes.

COMMENTS

The parties are advised that pursuant to Rule 5 VAC 5-20-120 C of the Commission's Rules of Practice and Procedure, any comments to this Report must be filed with the Clerk of the Commission in writing, in an original and fifteen copies, within twenty-one days from the date hereof. The mailing address to which any such filing must be sent is Document Control Center, P. O. Box 2118, Richmond, Virginia 23218. Any party filing such comments shall attach a certificate to the foot of such document that copies have been mailed or delivered to all other counsel of record and to any party not represented by counsel.

Respectfully submitted,

____

Alexander F. Skirpan, Jr.
Hearing Examiner